LOOKING AHEAD TO THE FUTURE

The benefits and uses of a trust

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WHAT’S INSIDE?

03 Why recommend using a trust?
05 What trusts do we offer?
06 The split trust
08 The gift trust
10 Trusts for joint life, first event plans
12 The business trust
14 The relevant life policy (RLP) trust
16 How has legislation affected trusts?

Important:
The information in this guide is based on our understanding of the law as it applies in the United Kingdom and HM Revenue & Customs practice at the time of publication, which is subject to change.

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The examples used throughout this guide are for illustrative purposes only.

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WHY RECOMMEND USING A TRUST?

There are three main reasons why trusts may be advantageous to your clients.

1. GETTING ACCESS TO THE PLAN PROCEEDS WHEN THEY'RE NEEDED MOST

If the plan is an own life plan and it’s not under trust, on death, the client’s personal representatives will need to obtain the appropriate ‘grant of representation’ before the proceeds can be paid. This process is known as ‘probate’ (or ‘confirmation’ in Scotland). Probate is the legal process of confirming who can deal with the estate of a person who has died before the assets can be distributed in accordance with their will. If someone dies intestate (that is, without leaving a will) this process can take several months or longer and in the meantime the proceeds can’t be paid on the plan.

By placing the plan under trust, probate isn’t required to release the plan proceeds, provided there is at least one surviving trustee at the time of your client’s death. Since the trustees are the legal owners of the plan, they can deal with the protection plan immediately.

2. NOMINATING BENEFICIARIES ON DEATH

Clients can ensure the correct beneficiaries receive the proceeds from their protection plan in one of two ways. Firstly, they can state in their will who they wish to benefit. However, choosing this route doesn’t avoid probate and a will may be contested.

An alternative is to write the plan in trust where the proceeds may be protected from creditors or anyone with a claim on the estate. In this way, the client can ensure that the people they want to receive the benefits actually do.

3. TAX PLANNING

Trusts can also be used for inheritance tax (IHT) planning purposes. IHT is payable at a rate of 40% on estates over the standard nil rate band of £325,000 (2019/20) although this excludes any amounts left to a UK domiciled spouse or civil partner. Married couples or civil partners can combine their IHT thresholds when the second person dies if the first person to die didn’t take full advantage of their own threshold. For example, if the estate was left to their surviving spouse. Any chargeable transfers made in the seven years prior to death must be added to the value of the estate. The value of any protection plan proceeds not under trust must also be added.

To avoid a possible charge to IHT, the plan may be written in trust. From 6 April 2013, if the spouse is non UK domiciled, the exemption is limited to £325,000.

The exemption is unlimited if the non-domiciled spouse elects to be deemed domiciled for IHT purposes. However, all of their assets will fall within the charge to IHT. The rules on electing to become deemed domiciled are complex and once made, the election is irrevocable. Independent professional advice should, therefore, be taken before making such a decision.
INTRODUCTION

THE BENEFITS AND USES OF A TRUST
WHAT TRUSTS DO WE OFFER?

We offer the following range of trusts for use with our protection plans:

1. The split trust discretionary or bare.
2. The gift trust discretionary or bare.
3. The split trust (jointly owned plans – survivor to benefit) discretionary or bare.
4. The gift trust (jointly owned plans – survivor to benefit) discretionary or bare.
5. The business trust.
6. The relevant life policy (RLP) trust.

You can set up a trust online or on paper. If a bare trust is selected, the settlor must name the beneficiaries in the trust form. The beneficiaries can’t be changed in the future even if circumstances change. However, if a discretionary trust is chosen, there’s a range of discretionary beneficiaries listed in the trust who may benefit from the trust at the trustees’ discretion.

Our discretionary trust forms include a list of the most common beneficiaries you would see in this type of trust. For example, the settlor’s spouse, children and grandchildren.

The discretionary trusts allow clients to add to the list of discretionary beneficiaries when setting up the trust or at a later date by nominating additional discretionary beneficiaries to the trustees in writing. Partners who aren’t spouses or civil partners (civil partnership being a form of legal union) aren’t automatically included in the list of discretionary beneficiaries, no matter the length of the relationship.

If your client would like their partner to be able to receive trust benefits, they can add them to the trust form when completing it or later, by writing to the trustees.

The discretionary beneficiaries have no immediate interest in the trust. They can potentially benefit at a later date if the trustees exercise their discretion to appoint trust funds to them in such shares as the trustees decide.

We offer standard forms for the trustees to appoint funds to beneficiaries, following payment of a claim.

While the trustees have flexibility to decide which beneficiaries to pay the trust fund to and in what shares, your client can provide the trustees with a letter of wishes to explain why they set up the trust, who they would like to benefit and what they would like the trustees to take into account when deciding which beneficiaries to make payment to. A letter of wishes doesn’t bind the trustees. This is why it’s important that your client chooses their trustees carefully. We offer a specimen letter of wishes.

If the client wants to change the trustees once a trust has been established, they can complete a standard form, called the ‘Deed of appointment and removal of trustees’. This form allows trustees to be added and/or removed on the same form. If a plan is to be assigned out of trust to one of the beneficiaries, a deed of assignment form can be provided. However, depending on the type of trust, a deed of appointment of a beneficiary form may need to be completed first. Again, we can provide a specimen.
THE SPLIT TRUST

This trust is available as both a discretionary trust and a bare trust.

**Purpose**
This trust is offered for use with Royal London Personal Menu Plans, Scottish Provident Self Assurance Plans, Scottish Provident Pegasus Plans and Bright Grey Personal Protection Menu Plans.

It’s designed for use where the donor wants to place any life cover in trust for their chosen beneficiaries but retain access to certain benefits. For example, critical illness cover or income protection where the donor survives diagnosis by 30 days.

**Beneficiaries**
The trust is available as a discretionary trust or as a bare trust. The donor is excluded from benefiting from the Life Cover or death benefit where the plan is a Scottish Provident Pegasus Whole of Life plan (including terminal illness). The trust may not therefore be suitable for a jointly owned, joint life, first event type plan if the survivor wants to benefit on first death as both donors are excluded from receiving any death benefits. In other words, if one of your clients died, the trustees couldn’t pay the proceeds to the survivor. Therefore, this trust is mainly aimed at single owner plans. However, we do offer a separate trust specifically designed for joint life, first event plans – more information of this can be found on page 10.

If the bare trust is selected, the beneficiary specified in the trust can’t be changed, even if it’s no longer desirable for this person to receive trust benefits. However, if the discretionary trust version is chosen, the trustees can appoint funds to any of the discretionary beneficiaries during the trust period and the donor can add to the list of discretionary beneficiaries at any time.

**IHT**
Firstly, only Life Cover (including terminal illness) and Critical Illness Cover (including total permanent disability benefit) where the donor doesn’t survive diagnosis by 30 days are gifted away for the benefit of the beneficiaries. All other benefits written under the trust will be held for the benefit of the donor absolutely and these benefits will remain inside the donor’s estate for IHT purposes if a claim is made.

The Life Cover and Critical Illness Cover or total permanent disability benefit where the donor doesn’t survive diagnosis by 30 days, should however be outside the donor’s estate on death for IHT purposes (subject to later comments).

If the bare trust version is chosen, the value of the trust fund will form part of the beneficiaries’ estates for IHT purposes. If the discretionary trust version is selected the value of the trust fund doesn’t form part of any beneficiary’s estate but it may be subject to IHT charges under the relevant property regime depending on the timing of the death of the life assured (examples of these charges are similar to the gift trust (see page 8)).

**What can be done if the split trust isn’t suitable?**
Where a split trust isn’t recommended for the plan, there are other trust solutions that may be considered.
Scottish Provident Pegasus Whole of Life Plans

Where a Scottish Provident Pegasus Whole of Life Plan includes Critical Illness Cover with the cover buyback option, the plan could be placed into a gift trust to avoid IHT on the death benefits.

However, this means the donor loses access to any critical illness payment. A probate trust would give the donor access to any critical illness proceeds, but the death benefit would not escape IHT.

Please note: A split trust isn’t normally suitable for use with a Scottish Provident Pegasus plan that includes Critical Illness Cover with the cover buyback option. This is because HM Revenue & Customs view the plan surrender value as giving rise to a gift with reservation of benefit for IHT purposes. This means any benefit payable to the discretionary beneficiaries will be treated as part of the donor’s taxable estate at date of death, with the result that IHT may be payable on it.

Example

Diane has taken out a Royal London Personal Menu Plan for Life or Critical Illness Cover of £200,000. She needs access to any critical illness payment. A probate trust would give the donor access to any critical illness proceeds, but in the event of her death she’d like the funds to be available for her husband. Both Diane and her husband have assets in excess of the IHT nil rate band and therefore she wants her trust to be set up in an IHT efficient manner. She has two sons who are currently at university.

Diane completes the discretionary version of the split trust form, which means the ownership of her plan transfers to the trustees. The benefit she has taken out (death or earlier critical illness) will only pay out once. The trust will split the benefit as necessary. In other words, if she suffers a critical illness this is defined as a ‘gifted benefit’, but if she survives diagnosis by 30 days the trustees are obliged to pay this to her. If she dies after the critical illness claim becomes payable, but within 30 days of diagnosis, the critical illness benefit will be held for the discretionary beneficiaries. The death benefit is defined as a ‘gifted benefit’ and if she dies her trustees may appoint the funds to any of the discretionary beneficiaries.

Diane’s two sons and her husband will automatically be included within the class of discretionary beneficiaries that appears in the trust form. The proceeds paid out on death will not fall into the IHT estates of the children nor her husband. With the trust being discretionary however, the trustees can appoint funds to her husband or the children or any of the other discretionary beneficiaries as required. Alternatively, the trustees have the power under the trust deed to lend funds to her husband to create a debt on his estate.

Periodic and exit charges may arise with this type of trust depending on the timing of death and when the funds are released from the trust (as described on page 9). However in this case, charges are unlikely to arise since the value of the proceeds to be paid is likely to be less than the nil rate band (assuming the nil rate band remains the same or greater than it is currently).
THE GIFT TRUST

This trust is available as both a discretionary trust and a bare trust.

**Purpose**
This trust allows the proceeds to be paid to anyone included in the trust other than the donor(s). As the donor is excluded from benefiting, care must be taken when using this trust if the plan includes any benefit payable other than death. The trust is suitable for IHT planning and is designed to avoid probate delays on death.

**Beneficiaries**
The donor can’t be included as a beneficiary regardless of the benefits placed under the trust.

**Bare trust**
The beneficiaries of the bare trust are fixed and can’t be changed, even if a change of circumstances means it’s no longer desirable for the beneficiaries specified in the trust to receive benefits. The bare trust offers certainty.

**Discretionary trust**
The trustees of the discretionary trust have the power to choose from the range of discretionary beneficiaries listed in the trust or added by the donor at a later date. This trust therefore offers more flexibility than the bare trust. Personal circumstances will dictate whether the bare trust or the discretionary trust is more appropriate.

However, the discretionary trust is often favoured due to its ability to accommodate a change in circumstances. For example, where a discretionary beneficiary dies during the donor’s lifetime or if the donor’s wishes as to which beneficiary they’d like to receive the payment change.

**IHT**
It’s the aim of both trusts that the plan and its proceeds are outside the donor’s estate on death for IHT purposes. With the bare trust the named beneficiary has an absolute right under the trust. Therefore, the value of the plan will be a part of their estate for IHT purposes.

With the discretionary trust version, the value of the plan doesn’t form part of the estate of any beneficiary. Instead the plan may in some circumstances be subject to IHT charges under the ‘relevant property regime’ (see example opposite).

The gift trust is primarily used for plans paying out on death only and is suitable for use with Royal London Personal Menu Plans, Scottish Provident Self Assurance Plans, Royal London Pegasus Whole of Life Plans, Scottish Provident Pegasus Plans and Bright Grey Personal Protection Menu Plans paying out on death only. The plan has been developed to provide proceeds outside the deceased’s estate to help pay any potential IHT liability.

However, it’s not suitable for use with a jointly owned, joint life, first event plan unless neither planholder needs access to the plan proceeds since the donors would both be excluded from receiving benefits from the trust.

In other words, if one of your clients died, the trustees could not directly pay the proceeds to the survivor. For that type of plan, typically the gift trust (jointly owned plans – survivor to benefit) would be used as described on page 10.
EXAMPLE - GIFT TRUST

David is married with three children. He has made no previous gifts for IHT purposes and decides to take out a single life plan for £500,000 and put it into a gift trust choosing the discretionary trust version with the children and his wife automatically included in the class of discretionary beneficiaries. He appoints his wife and his sister as additional trustees.

In the event of his death, the trustees could appoint funds to his children or his surviving spouse as they have discretion over the trust assets. Capital can be paid out of the trust or alternatively the trustees have the power to lend funds to his wife to create a debt on her estate.

EXAMPLE OF CHARGES UNDER THE RELEVANT PROPERTY REGIME

1. Assuming David dies five years later and the proceeds are paid to his wife immediately, no IHT charges will arise in the trust. The funds will then of course form part of his wife's estate. Charges would only arise if the proceeds were held in trust at the tenth anniversary of establishing the trust.

2. If David's still alive at year ten but dies in year 15 then what is the situation? First of all there will be no IHT charge at year ten provided that the valuation rules described on page 5 give a figure below the nil rate band. Once death occurs in year 15, no charge should arise providing the proceeds don't remain in trust. The proceeds would need to remain in trust until year 20 for a charge to arise.

3. If David dies shortly before the tenth anniversary of setting the trust up and the proceeds are paid to David's wife six months after the tenth anniversary, then the following charges would apply (assuming the nil rate band is still £325,000).

**Periodic charge at tenth anniversary**

\[(£500,000 - £325,000) \times 6\% = £10,500\]

This gives an effective rate of tax of 2.1% (that is, £10,500/£500,000)

**Exit charge**

When the plan proceeds are paid out of the trust the following charge will arise:

\[£500,000 \times 2.1\% \times \frac{2}{40}^* = £525\]

*Six months represents two quarters into the next ten year period (each year is divided into quarters which means that over a ten year period there will be 40 quarters).
As outlined previously, the gift trust and the split trust are not generally suitable for jointly owned plans payable on first event. This is because in many cases, the surviving planholder wishes to benefit from the proceeds, for example, to repay an outstanding mortgage.

Given these trusts are designed to avoid IHT on payment of any death benefits, both donors need to be excluded as beneficiaries of the trust. This means that in the event of death, the funds are held in trust for other beneficiaries.

For this reason, it may be appropriate to consider writing two separate plans so that each life assured can write their respective plans in trust and the other can benefit as they’re not a donor on that plan. It can often be just as cost effective to have two plans rather than one joint life plan.

However, there may be circumstances where a joint life plan is more appropriate or where clients wish to place an existing joint life plan in trust so that if both lives die together the proceeds will be outside both estates for IHT purposes yet if only one life dies, the survivor will benefit.

With this in mind, we offer two trusts available for such plans. Both trusts state that if the surviving donor is alive 30 days after the first death or accepted terminal illness claim, they’ll be entitled to any plan proceeds.

However, if they fail to survive that 30 day period, the funds will be held on trust (either a bare or a discretionary version is possible) for other beneficiaries and this will avoid IHT on either donors’ estate.

**Gift trust (jointly owned plans – survivor to benefit)**

This is a variation on the gift trust as described earlier on page 8. This trust is designed for use with joint life plans where there are to be no retained benefits (for example, Life Cover only) or for Scottish Provident Pegasus Whole of Life plans where the split trust isn’t suitable.

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**EXAMPLE - GIFT TRUST**

Mike and Annie have a joint life, first event plan for £200,000, which was taken out for mortgage protection purposes. If one of them were to die, the survivor would wish to use the proceeds to pay off the outstanding mortgage.

However, if they both died at the same time, they want to make sure that the proceeds are not added to their estate for IHT purposes. So they place their plan under the gift trust (jointly owned plans – survivor to benefit). They choose the discretionary version of the trust and their four young children are automatically included as discretionary beneficiaries.

Unfortunately, two years later they are involved in a car accident and tragically Mike dies. Under the terms of the trust Annie is entitled to the plan proceeds if she is still alive 30 days later. She can then use the funds to repay the mortgage.

However, if Annie had died a week after the accident, the trustees would hold the funds on discretionary trust for the children and they could use the capital to repay any outstanding debts or alternatively continue to hold the proceeds in trust for the children until they’re older. The proceeds wouldn’t be subject to IHT in either Mike or Annie’s estates.
Split trust (jointly owned plans — survivor to benefit)

This is a variation on the split trust as described earlier on page 6. This trust is designed for use with joint life plans where there are retained benefits (for example, Income Protection or Critical Illness Cover or Life or Critical Illness Cover).

Again, the trust contains a survivorship clause. If the survivor is still alive 30 days after first death or accepted terminal illness claim, the survivor will benefit from the death claim proceeds and if not, proceeds will pass to the trustees to hold on bare or discretionary trust (depending which version is selected) for the beneficiaries as appropriate.

If either life assured suffers a critical illness or total permanent disability, the proceeds will benefit the donors if both (or either of them) survive diagnosis by 30 days. If both donors fail to survive diagnosis by 30 days, the critical illness or total permanent disability benefit is held on trust for the beneficiaries.

This trust is available for use with Royal London Personal Menu Plans, Scottish Provident Self Assurance Plans, Scottish Provident Pegasus Whole of Life Plans and Bright Grey Personal Protection Menu Plans.

EXAMPLE - SPLIT TRUST

So, continuing the example of Mike and Annie, if the plan covered Life or Critical Illness Cover, it could be placed into the split trust so that they could receive any Critical Illness Cover (assuming at least one donor survives a diagnosis of critical illness by 30 days). The situation on death or terminal illness however, would be the same as for the gift trust as detailed on page 10.

Inheritance Tax receipts were around £5.2 billion in 2017-18, an increase of 8% compared to 2016-17.

Source: HM Revenue & Customs, Inheritance Tax Statistics (July 2018).
**THE BUSINESS TRUST**

This trust is available as a discretionary trust.

**Purpose**
This is a discretionary trust designed mainly to allow the proceeds of the plan to be used by the remaining partners, members or shareholders to buy the interest or shares of the critically ill or deceased co-partner, co-member or shareholder.

It may also be used for a partnership established in England, Wales or Northern Ireland where the partners want a key person plan for the benefit of the surviving partners. In England, Wales and Northern Ireland, a partnership isn’t a separate legal person, so can’t directly own a protection plan. The key partner could therefore take out an own life plan and write it under the business trust for the benefit of the partners who may then introduce the funds back into the business.

This can also be appropriate for Scottish partnerships and LLPs. However, as the partnership in Scotland and LLP are separate legal entities, it is perhaps more common for the partnership or LLP to own the key person plan.

Each business owner would set up an own life plan to be issued subject to a business trust. The business owners may need to consider putting in place a cross-option agreement and equalising premiums as part of an ownership protection arrangement.

Our guide to business protection explains this and also outlines other methods of setting up business protection.

**Beneficiaries**
The other co-owners involved in the business are included in the list of discretionary beneficiaries in the trust. The trustees can appoint funds to any of the discretionary beneficiaries including new partners, members or shareholders.

The settlor is a discretionary beneficiary to allow for situations where it’s appropriate for the plan to be transferred back to them. For example, if the settlor leaves the business at a later date.

Any partners, members or shareholders who are not participating in the business protection arrangement should be excluded from benefiting.

The business trust refers to settlor rather than ‘donor’ since there is no intention to gift the plan as this trust is used as part of a commercial arrangement.

**IHT**
Providing each partner, member or shareholder is placing their plan into trust only for the other individuals involved in the protection arrangement – and providing it is a genuine commercial arrangement – then the proceeds should fall outside the settlor’s estate on death for IHT purposes.

This is because the creation of the trust isn’t a gift, but is part of a reciprocal commercial arrangement.
EXAMPLE - IHT

Elizabeth, James and Duncan are equal shareholders. The business is worth £300,000. Each of them buys cover of £100,000 placed in a business trust for the other two as discretionary beneficiaries.

An option agreement is drawn up under which the shares of the deceased can be sold to the remaining shareholders should the deceased's executors or the surviving shareholders wish to do so.

Pre owned asset tax (POAT)

Under current rules, there is a risk that including the settlor as a discretionary beneficiary could result in POAT becoming payable. At commencement however, a POAT charge is initially unlikely as there’s little value inside the trust, that is, a life plan which hasn’t paid out.

This may change if, for example, the plan pays out on a critical illness and the proceeds remain inside the trust, or if the life assured falls seriously ill and their ongoing plan is considered to have acquired a significant market value.

As a result of this, we offer a deed for the trustees to remove the settlor as a potential beneficiary. If they want to complete it, this can be done at the start or at a later date if they prefer. In any event, it doesn’t need to be returned to us.

As long as they all take out this cover under a proper commercial arrangement — the plan proceeds shouldn’t be within their estates at death for IHT purposes.

The plan proceeds can be used to buy the shares from the critically ill or deceased shareholder.
THE RELEVANT LIFE POLICY (RLP) TRUST

This trust is available as a discretionary trust.

Purpose
This is a discretionary trust designed to allow employers to set up life cover for an employee in a tax efficient manner, without using a registered death in service group scheme. The trust is used to pay the benefit to the employee’s dependants.

The trust also demonstrates that the plan proceeds will be payable to individuals (the employee’s dependants) which is one of the legislative requirements to qualify as a relevant life plan.

The plan is set up by the company and then put into trust for the benefit of the employee’s dependants.

Beneficiaries
The employee, their children, spouse or civil partner are included in the list of discretionary beneficiaries in the trust. The trustees can appoint funds to any of the discretionary beneficiaries of the trust and these can be added to by the employee completing a nomination form. It’s also possible for the benefit to be paid to a further trust, such as a bypass trust. If this is required, then the name of the trust should be added to the list of discretionary beneficiaries.

The employer or co-shareholder shouldn’t be listed as a discretionary beneficiary.

The employee is a discretionary beneficiary to allow for situations where it’s appropriate for the plan to be transferred to them. For example, if the employee leaves the business at a later date.

IHT
As the benefit is paid into the trust, the proceeds will be outside the employee’s estate on death for IHT purposes. The employer will be a trustee. An additional trustee must be added to act with the employer where the business isn’t a separate legal entity from the owner i.e. a sole trader or partnership. If the employee is to be the additional trustee, a further additional trustee should also be added to ensure that there would be two trustees available to act in the event of the employee’s death.

An additional trustee may be a family member of the employee, such as a spouse, or perhaps an independent trustee, such as a solicitor. The employee has power under the trust to change the trustees.
INTRODUCTION
THE BENEFITS AND USES OF A TRUST
HOW HAS LEGISLATION AFFECTED THE USE OF TRUSTS?

The Finance Act 2006 dramatically changed the IHT treatment of many commonly used trusts, including flexible power of appointment trusts offered for use with protection plans. A flexible power of appointment trust is an interest in possession trust under the terms of which the trustees have the power to change the beneficiaries of the trust.

Protection plans written into trust, other than bare or trusts for the disabled, after 22 March 2006 will be within the relevant property regime.

On creation
In general, where a trust is created by a regular premium protection plan, there’ll be no 20% lifetime IHT charge since the value of the gift made is simply the premiums paid on the plan. Such premiums are usually exempt from IHT either because they fall within the annual exemption (currently £3,000 a year) or because the premiums qualify as normal expenditure out of income based on the proposer’s spendable income.

Even where large premiums are paid and neither of the exemptions apply, provided the plan owner hasn’t used their nil rate band, no tax charge should arise provided that the premiums over a seven year period don’t exceed the available nil rate band.

Where an existing whole of life plan is placed into trust, the value of the initial gift is the greater of the market value (usually the surrender value) or the premiums paid to date. Again, provided this is within the available nil rate band, no tax charge will arise.

In the case of an existing term or whole of life plan, where there’s no surrender value, there’s usually no value placed on the gift unless the client’s in serious ill health at the time the trust was created. If the client is seriously ill (in practice, where they die within two years of the transfer to the trust), HM Revenue & Customs (HMRC) will usually treat the value of the plan as the sum assured, although perhaps this may attract a discount.

A form IHT 100a return may need to be submitted to HMRC depending on the value of the plan transferred and taking into account any other chargeable lifetime transfers made by the client in the last ten years. In comparison, the transfer of a plan to a bare trust will be a potentially exempt transfer (PET) unless it’s otherwise exempt.
Ongoing periodic and exit charges

Periodic and exit charges apply where there’s a value within the trust. The valuation rules described above for whole of life plans apply equally for the purposes of these charges.

HMRC has confirmed that they don’t expect individuals to have medicals every ten years for the purposes of the legislation. Provided the individual isn’t seriously ill to the best of their knowledge and belief, no further action would be needed.

HMRC has also indicated that for the purposes of the ten yearly charge, generally the surrender value of the plan will be acceptable, though bear in mind that for a whole of life plan the total premiums paid over the ten year period will be used if greater than this figure.

The value of the trust at the tenth anniversary (and each subsequent tenth anniversary) may be subject to IHT at 6% on the excess above the nil rate band at that time.

More commonly, charges may arise if a claim is made on the plan and the proceeds remain in the trust for a period of time. An exit charge shouldn’t arise where proceeds are paid out within the first ten years if the value of the initial gift (including the cumulative total of the settlor’s chargeable transfers in the seven years prior to the gift) plus any added property is below the nil rate band. If funds continue to be held in trust beyond a ten year anniversary any exit charges will depend on the rate of the previous periodic charge.

EXAMPLE

It’s May 2015. David doesn’t want to make any lifetime gifts. Instead he takes out a Royal London Personal Menu Plan with a sum assured of £400,000 payable on death which is intended to meet the IHT liability on his estate. He writes this in a discretionary gift trust for the benefit of his three children.

The monthly premiums qualify as normal expenditure out of income and therefore no immediate IHT charge will arise on setting up the trust. Assuming he dies 15 years later the IHT implications for the trust will be as follows:

<table>
<thead>
<tr>
<th>May 2025 (year ten):</th>
<th>David dies 2030:</th>
</tr>
</thead>
<tbody>
<tr>
<td>No periodic charge (assuming David is not in seriously ill health).</td>
<td>Claim is made. If funds are paid out prior to May 2035 – no IHT implications. If held in trust beyond May 2035 (that is, the following tenth anniversary) – IHT charge possible. 6% x (value of trust less the nil rate band).</td>
</tr>
</tbody>
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In the vast majority of cases, no IHT liabilities will arise in connection with protection plans in trust.

No such charges can arise where the plan has been placed in a bare trust since the value of the plan will be part of the named beneficiaries’ estates. An IHT liability could of course arise if the named beneficiary dies at the same time as the life assured since the proceeds will be added to that beneficiary’s estate.

Please note: Only a unit-linked whole of life plan will attract a surrender value.
So, should you still recommend the use of a trust?
The answer is most certainly yes. Even if the trust does suffer an IHT charge at 6% because, for example, the life assured dies on or around a tenth anniversary, this is usually preferable to suffering a potential charge at 40% on the plan proceeds as part of the estate.

Clients wishing to avoid this regime could of course consider writing their plans on a life of another basis. This will avoid probate and IHT on the death of the life assured but doesn’t solve either problem if both the owner and life assured die at the same time. In addition, insurable interest problems may arise.

If the client wants flexibility to change beneficiaries yet still minimise charges, a discretionary trust could be used where the plan under trust has a sum assured valued at less than the available nil rate band since no IHT charges will arise within the trust.

For sums assured in excess of the nil rate band, consideration could be given to writing a number of plans each with a sum assured less than the nil rate band. Each plan can then be placed into a separate trust and each trust should have its own nil rate band provided the trusts are established on separate days. This is called a ‘Rysaffe’ arrangement.

A bare trust would avoid the charges, but this offers no flexibility in changing beneficiaries and as noted previously, if the beneficiary dies at the same time as the life assured, an IHT charge may arise on the beneficiary’s estate.

Please note: A different tax regime applies to trusts created prior to 22 March 2006 and we would recommend that separate independent advice is taken in relation to such trusts.
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